UNITED NATIONS

TD

United Nations Conference on Trade and Development

Distr.
GENERAL

TD/B/COM.3/43
21 December 2001

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Commission on Enterprise, Business Facilitation and Development
Sixth session
Geneva, 18-22 February 2002
Item 4 of the provisional agenda

IMPROVING SME COMPETITIVENESS: ACCESS TO FINANCE AND E-FINANCE

Note by the UNCTAD secretariat

CONTENTS

Chapter			Page
	Introduction		2
I.		Policy issues for consideration by the Commission	3
II.		Main outcomes of the Expert Meeting	5
III.		Proposals for UNCTAD's future work, taking into account the Outcome of the Expert Meeting	9
	Annex		11

GE. 01-53522 LS

ENG

INTRODUCTION

1. The Expert Meeting on Improving the Competitiveness of SMEs in Developing Countries: The Role of Finance, including E-Finance, to Enhance Enterprise Development was held in Geneva from 22 to 24 October 2001. It was attended by 120 experts and resource persons. A total of 44 countries were represented: 29 from G77, 12 from Group B and 3 from Group D.

2. The Expert Meeting discussed practical solutions from the point of view of the supply side (banks, other financial institutions) and the demand side (small and medium-sized enterprises (SMEs)). It also discussed the emerging opportunities for e-finance, including e-payments, Internet banking, e-trade finance and e-credit information. These discussions were enriched by documentation prepared by the secretariat (see annex) and over 50 expert presentations and papers. After an exchange of views, the experts adopted the Outcome of the Expert Meeting, which contained policy options and practical measures that could be taken by Governments, the private sector, non-governmental organizations (NGOs), international organizations and in particular UNCTAD. This note focuses on the main outcomes, which are contained in sections A and B of chapter II. The secretariat will supplement this analysis with the responses from Governments on the feasibility and desirability of the recommendations.

Chapter I

POLICY ISSUES FOR CONSIDERATION BY THE COMMISSION

A. Finance

3. The experts noted that sustainable economic growth is strongly related to the rate of enterprise creation and technical innovation. Vigorous enterprise creation depends on a nation's entrepreneurial culture and the ease with which SMEs can be started and financed. Access to finance is therefore a crucial determinant of a nation's competitiveness. In developed and developing countries alike SMEs provide at least 60 to 70 per cent of all jobs. However, financial institutions are generally biased against lending to SMEs for reasons such as perceived high risk and high transaction costs. The preferred customers of commercial banks are Governments and large corporations. The experts examined a number of financial innovations being used by banks in developed countries that make SME lending highly profitable.

4. The experts indicated that overcoming the reluctance of banks would require public–private sector dialogue, modification of regulatory requirements, dissemination of financial innovations and the combining of business with financial services via partnerships. They agreed that well-regulated and properly functioning financial systems were necessary, as well as restraint by the Government in terms of its borrowing from the private sector. As long as Governments in developing countries continue to crowd out private sector borrowing, commercial banks will have no interest in adopting any of the financial innovations being used with such success in developed countries and some developing countries. Thus, there are two essential steps that Governments must take: first, they must achieve fiscal balance and reduce borrowing; and second, they must remove unreasonable restrictions on SME lending while at the same time maintaining prudential supervision.

5. Raising awareness via public–private sector dialogue among government regulators, banks, SME representatives and the international community can help resolve the constraints which banks face in serving SMEs, and promote financial innovations which reduce perceived risks and costs. The ability to adopt the many innovations examined by the experts and described in detail in the secretariat's background paper requires that development agencies and financial institutions help commercial banks in developing countries to improve their core competencies through capacity-building.

B. E-finance

6. It is important to draw the Commission's attention to the experts' general recommendation related to the importance of putting in place modern and technology-neutral monetary and financial regulations and institutions in developing and transition economies. On the one hand, such a regulatory and institutional environment should not stifle financial innovation and the introduction of new Internet-based technologies in the financial sector. On the other hand, it should decrease barriers facing SMEs' access to finance and e-finance at the

local, regional and global levels. Furthermore, the borderless nature of e-finance greatly increases the importance of coordination among national financial supervisory authorities for the purpose of better managing systemic risks originating in the financial sector.

7. Another general precondition for developing e-finance is the creation in developing and transition economies of an e-commerce-friendly policy framework in order to improve telecommunications infrastructure and connectivity, adopt internationally compatible laws on e-commerce, e-contracts and e-signatures, enhance the security of electronic communications and undertake other e-commerce capacity-building measures.

8. Experts agreed that building up e-finance arrangements for developing country SMEs, including automated and regularly updated Internet databases on SMEs' performance, could actually improve their risk profile and hence their access to finance and e-finance. They considered those modes of e-finance that are of immediate relevance to SMEs' requirements, including e-payments, Internet banking, e-trade finance, e-credit insurance and e-credit information, mentioned success stories in those fields and proposed concrete ways of developing e-finance services for SMEs.

Chapter II

MAIN OUTCOMES OF THE EXPERT MEETING

A. Finance

9. The Expert Meeting reviewed the various ways and means of overcoming the bias of financial institutions against lending to SMEs. The experience of many local financial institutions in developed countries shows that with the correct strategy and appropriate information technologies, lending to SMEs has been turned into a highly profitable business. Risk can be reduced by means of various risk management techniques such as credit scoring, external credit rating and risk self-assessment, all of which could be better applied through the use of cost-saving information technologies. Streamlined lending processes, specialized lending departments and a portfolio of products and services adapted to SME needs can also cut costs. The most advanced banks have adopted a strategy to improve their core competencies by adopting those sophisticated credit techniques, strengthening management and information systems and developing highly efficient automatic processes, efficient marketing and distribution, and developing close ties to clients. The experts agreed that, suitably adapted, these strategies could be applied to developing countries and economies in transition.

10. They observed that in developing countries equity funds, and especially venture capital funds, have much greater difficulty in serving SMEs or even identifying fundable ones. Such difficulties severely limit the amount of equity and venture capital funds available to SMEs in developing countries and particularly least developed countries (LDCs). In the case of the LDCs, there is a special need for public–private investment funds devoted to the support and promotion of SMEs and information infrastructure development.

11. The experts reviewed a number of financial services complementary to credits and equity capital, such as leasing, credit insurance and mutual guarantee schemes. These could substantially improve SMEs' access to credit. They recommended that Governments that wish to use loan guarantee schemes ensure that they reach the target beneficiaries, balance risk-sharing among all parties and avoid moral hazard.

12. The experts agreed that the provision of medium- and long-term finance should be closely linked to the delivery of business development services so as to improve both the viability of SMEs and their ability to repay loans. They urged that partnerships be formed between financial institutions, business associations, networks of entrepreneurs and business development service providers which were effective in combining financial services with business development services. One area where SMEs have particular difficulty is the provision of reliable financial information. This severely limits their ability to generate creditor and investor confidence. The experts agreed that Governments could influence reliability of financial information provided by SMEs by adopting user-friendly accounting and reporting requirements.

13. At the international level, the experts urged that those Governments, international organizations and NGOs examining the issues of financing for development note that SMEs are one of the most underserved sectors in developing countries. Those charged with finding new ways to promote financing for development could consider developing debt swaps (within existing aid budgets) as a means of strengthening local financial institutions by providing them with medium- and long-term finance for SMEs, and by taking into consideration finance and guarantee schemes in local currency. Debt swaps could also be used to provide business development services. This could be useful for complementing the heavily indebted poor country (HIPC) debt alleviation facility and for countries not benefiting from that facility.

14. The recommendations of the Expert Meeting could be considered by the Commission in terms of their feasibility and likelihood of adoption. The recommendations meeting those minimum criteria are listed below and are followed by a brief commentary.

Governments

15. *Avoiding crowding out of the private sector, taking into account the specific requirements for medium- and long-term investment finance for SMEs, and ensuring that commercial lending to SMEs is on a sustainable basis.* (paras. a–b)

16. *Designing loan guarantee schemes that reach target beneficiaries, ensure balanced risk-sharing and avoid moral hazard.* (para. c)

17. *Requiring commercial banks to disclose the composition of their loan portfolios, particularly the percentage of loans going to SMEs.* (para. d)

18. *Improving the reliability of financial information provided by SMEs by adopting user-friendly accounting and reporting requirements.* (para. e)

19. Balancing public and private needs would be the most difficult recommendation to implement, but success in this area would dramatically improve SMEs, ability to access finance. Many Governments start loan guarantee programmes, and could at least follow best practices. It is a proven fact that disclosure often improves behaviour. There was a dramatic increase in SME lending after the Small Business Administration in the United States required banks to disclose the percentage of their portfolio going to SMEs. It was obvious who the leaders were and that they were not losing money. This gave those lagging behind an incentive to improve their performance and their image. Lack of reliable accounting information provided by SMEs is a problem in developed and developing countries. Therefore, in the interest of creating transparent, reliable and comparable financial information, Governments could press for an international guideline which they could then tailor to their particular circumstances.

International community

20. *Developing, whenever appropriate, debt swaps within existing aid budgets as a means of strengthening local financial institutions by providing them with medium- and long-term finance for SMEs.* (para. y)

21. *Disseminating information on financial innovations and assisting commercial banks in developing core competencies in credit policy making, risk management, credit information and management systems, and efficient marketing and distribution.* (para. aa)

22. *Developing common standards and systems to link commercial banks and micro-finance institutions to increase outreach and accelerate the mainstreaming of productive poor into the formal financial system.* (para. ff)

23. The international community, when it considers financing for development, should not forget the most underserved sector – SMEs. SMEs can grow and increase their contribution to job and income creation only if they can afford to grow. Financing SMEs can promote development. There is such a wealth of financial innovation available in the developed countries that it could easily be spread to developing countries. The World Bank and the International Finance Corporation are in a unique position to end the knowledge gap in a systematic way. The donor community has heavily supported micro-lending. However, micro-credit helps micro-entrepreneurs to survive but not to make their businesses grow. Therefore, there is a need to provide them with a link to the business and financial services offered to SMEs.

B. E-finance

24. The Expert Meeting stressed the revolutionary impact of open Internet technologies and platforms on financial services. Internet-related innovations make it possible to reduce transaction costs drastically, as well as to increase the speed of financial operations and greatly improve risk mitigation, *inter alia* as a result of the introduction of e-payments, Internet banking, online trade finance, online credit information and other e-finance techniques.

Private and public sectors

25. Modern Internet-based automated data mining technologies are making it possible to build up huge credit information databases and apply modern credit analysis and related credit appraisal, scoring and rating techniques. Consequently, a much improved system of appraisal of SME-related credit risks and processing of their credit applications might become a reality. Finding the best ways of introducing those innovations into developing and transition economies is becoming a pressing policy priority.

26. Developing online credit information and credit scoring and rating databases for SMEs from developing and transition economies should also become an important element of international capacity-building and technical assistance efforts. This should help to greatly shorten the SME credit appraisal process and hence improve the access of SMEs to finance and e-finance both locally and internationally.

27. Local, regional and global e-finance platforms, with the active participation of financial service providers and other companies from developing and transition countries, should also help to make e-finance services available to the enterprises of their countries.

28. SMEs need to acquire Internet-based technologies and skills, as well as to enter into trade-related e-financing arrangements and to lay foundations to develop a strategy for online access to longer-term finance and investment resources. Developing alternative bilateral and multilateral online payments and financing arrangements, such as online clearing houses, could expand the productive and trading frontiers for SMEs from developing and transition countries.

International organizations

29. The international financial institutions (IFIs), through co-financing, training and other technical assistance, should help local financial service providers to introduce e-finance and related financial innovation and thus to help them to seize the possibilities to tap into e-finance-related efficiency gains. They should also participate in the creation of local and regional e-finance platforms of various types with a view to improving the quality of services rendered to SMEs.

30. Equally, IFIs should help the SME sector in developing and transition economies to acquire e-finance-related technologies and skills as a part of improving their competitiveness and participation in the global economy.

31. IFIs should also support Governments, public and private sector entities and NGOs in implementing the above-mentioned recommendations on e-finance.

32. To that end, the international organizations should adopt a more structured approach in assisting the transfer of e-finance-related technology and know-how to local financial service providers and SMEs, and improve the cooperation between public agencies in that field.

Chapter III

PROPOSALS FOR UNCTAD'S FUTURE WORK, TAKING INTO ACCOUNT THE OUTCOME OF THE EXPERT MEETING

Commission on Enterprise, Business Facilitation and Development

33. The Expert Meeting proved that there are certain topics that can attract large numbers of experts because they are of interest to developed and developing countries, and to the public and private sectors, but which for one reason or another are not on the international agenda. Although financial issues and development finance are discussed in many forums, SME finance and e-finance are not widely discussed. There are forums for discussing questions of financial stability and reform as well as financing for development. These are largely macro issues. They are vast topics with many aspects, such as compatibility of international and national prudential regulations, allocation of credit between the Government and the private sector, particularly the most underserved segments, dissemination of financial innovations which improve profitability, capacity-building, provision of business development services with financial services, and transfer and absorption of information technologies. At the end of the Expert Meeting there was general agreement that it had been just a first exchange of views, and that the amount of time available had been insufficient for discussion of all the relevant topics. The experts recommended to the Commission that it keep this topic on its agenda for the next year to further develop the theme and coherent approaches to SME finance and e-finance.

34. *Selecting a topic for the next two years which develops coherent approaches to SME finance, e-finance and non-financial business support services, taking into consideration the work of other agencies, in order to contribute to the effectiveness of UNCTAD's research, intergovernmental discussions and technical cooperation and ultimately to UNCTAD XI.* (para. nn)

35. One of the themes that clearly emerged from the discussions was the pivotal role of medium- and long-term finance for SMEs seeking to enhance their operations by adopting modern technologies. Access to the latter is crucial for improving the competitiveness of enterprises and nations as a whole. At the same time, financial service providers are rapidly moving towards new, mainly e-finance-based technologies. Therefore, an Expert Meeting on the financial, fiscal and trade-related incentives for promoting financing for new technologies for SMEs would be highly relevant, especially for developing countries, and would also be a useful follow-up to the Expert Meeting held in October. Another theme of particular relevance for an Expert Meeting could be new developments in e-financing of enterprises from developing and transition economies.

A. Financing for SMEs

UNCTAD

36. *Completing its work on a user-friendly accounting framework for SMEs that will allow them to produce transparent, reliable and uniform financial and business information and reporting back to the Commission as soon as possible.* (para. pp)

37. *Ensuring, in its technical cooperation programmes for entrepreneurship, that business development services are linked to financial services, and developing the necessary products and services within its programmes in order to facilitate this.* (para. qq)

38. *Developing, together with other relevant international agencies, programmes for women entrepreneurs to facilitate their access to finance, extrabudgetary funds permitting.* (para. rr)

39. All of the recommendations in this section of the Outcome are feasible and some are already being implemented (accounting, women entrepreneurs). These efforts need to be reinforced and adequately funded.

B. E-finance for SMEs

40. The Expert Meeting stressed that UNCTAD should continue systematic research into the impact of various online financial services on economic development, and in particular on opportunities opened up for SMEs to improve their access to finance and e-finance. Major inputs to such research should come from regular forums organized by UNCTAD, including regional seminars and group training, which bring together experts from Governments, central banks, financial service providers and the corporate sector, as well as academia. UNCTAD publications and e-commerce-related events should show to developing and transition countries the advantages of electronic finance at the local, regional and global levels.

41. UNCTAD should also encourage Governments, central banks and financial institutions to collect information on e-commerce and particularly e-finance. That information could be *inter alia* used by UNCTAD in its analysis, intergovernmental deliberations and technical cooperation.

42. Aspects of e-finance that are more relevant to the needs of SMEs should be equally included in UNCTAD technical cooperation activities in the area of e-commerce, and coordination and synergies with other international organizations active in this field should be ensured.

Annex

"Finance and e-finance for SMEs as a means to enhance their operations and competitiveness" (TD/B/COM.3/EM.13/2).

"Best practices in financial innovations for SMEs" (UNCTAD/DITE/TEB/Misc.1).

"E-finance and small and medium-size enterprises in developing and transition economies" (UNCTAD/SDTE/Misc.48).

"Report of the Expert Meeting on Improving the Competitiveness of SMEs in Developing Countries" (TD/B/COM.3/39-TD/B/COM.3/EM.13/3).

The papers on e-finance are available on the Electronic Commerce Branch website www.unctad.org/ecommerce.